FINANCIAL TRANSPARENCY GLOSSARY

Transparency International is the global civil society organisation leading the fight against corruption. Through more than 90 chapters worldwide and an international secretariat in Berlin, we raise awareness of the damaging effects of corruption and work with partners in government, business and civil society to develop and implement effective measures to tackle it.

ISBN: 978-3-943497-51-9

Printed on 100% recycled paper.

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GUIDE TO TERMINOLOGY

Transparency International believes that it is essential to promote greater transparency, integrity and accountability of financial institutions to avoid another global financial crisis and crack down on corrupt and unethical behaviour. We seek to improve behaviour in financial firms by increasing transparency, embedding a culture of integrity and improving accountability to a broad range of stakeholders. We seek policy and legislative change that makes it more difficult and less attractive to profit from the proceeds of corruption.

Public anger rarely translates into direct consumer action. One reason is that the financial sector is often seen to be very complex. This tool is intended to explain and clarify some of the most crucial terms in clear and plain language.

ASSET RECOVERY

Asset recovery is the legal process through which a country, government and/or its citizens recover from another jurisdiction the resources and other assets that were stolen through corruption.

Why it matters*: Governments must ensure greater domestic and international inter-agency cooperation to enable more effective and faster cross-border information-sharing. Governments should put in place legal frameworks to enable victims of corruption and civil society to take asset recovery cases to court, in the countries from where assets were stolen and those in which they were deposited.*

AUTOMATIC EXCHANGE OF INFORMATION

Automatic Exchange of Information (AIE) is when the tax authorities of two or more States share financial information related to all types of wealth (including immovable property such as houses or land)and taxable activity (e.g. dividends, interests, royalties, salaries, pensions, VAT refunds, etc.) on an automatic, periodic basis. In this system information is routinely collected in the country where the taxable activity occurs or the wealth is held, and shared with the country where taxes are due without a formal request being required. The system can be formalised in either bilateral or multilateral agreements between state parties.

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BASE EROSION AND PROFIT SHIFTING (BEPS)

Base Erosion and Profit Shifting (BEPS) refers to the erosion of a national tax base and one process by which this happens. This process is when Multinational Companies shift the profits generated in the country outside and into jurisdictions such as offshore financial centres with lower or zero tax, thus minimising their tax burden. This practice is legal, but aside from eroding the tax base of countries where the profits have been made it also creates an unbalanced playing field, since small and medium sized businesses do not normally have access to these profit shifting schemes and therefore pay much higher taxes than multinationals.

Why it matters*: Companies should enhance levels of corporate transparency, since this allows citizens to hold companies accountable for the impact they have on their communities. Multinationals operate through networks of related entities incorporated under diverse legislation that are inter-related through myriad legal and business connections. Without transparency, many transactions are almost impossible to trace.*

BENEFICIAL OWNERSHIP

A beneficial owner is the real person who ultimately owns, controls or benefits from a company or trust fund and the income it generates. The term is used to contrast with the legal or nominee company owners and with trustees, all of whom might be registered the legal owners of an asset without actually possessing the right to enjoy its benefits. Complex and opaque corporate structures set up across different jurisdictions, make it easy to hide the beneficial owner, especially when nominees are used in their place and when part of the structure is incorporated in a secrecy jurisdiction.

Why it matters*: Governments should establish mandatory, public registers that disclose the beneficial ownership of trust funds and companies. Public registers of beneficial ownership would allow ill-gotten gains to be more easily traced and make it more difficult and less attractive for people to benefit from the proceeds of corruption and crime.*

ENHANCED DUE DILIGENCE

Enhanced Due Diligence is the term used to refer to Know Your Customer money laundering measures that include validation and documentation by third parties and applies to situations where higher risk clients and politically exposed persons such as senior politicians, are concerned.

Why it matters*: Governments must ensure banks are serious and effective in conducting enhanced anti-money laundering due diligence checks on politically exposed clients.*

COUNTRY BY COUNTRY REPORTING

Country by Country reporting is a form of financial reporting in which multinational corporations produce certain financial data disaggregated by country and for each country in which they operate. This data includes sales and purchases within the corporation and externally, profits, losses, number of employees and staffing costs, taxes paid and tax obligations, summaries of assets and liabilities. Currently, consolidated financial statements are the norm.

Why it matters*: Mandatory disclosure of payments and operations on a country-by country basis mitigates political, legal and reputational risks and generates timely, disaggregated and easily comparable data. Companies should ensure high levels of corporate transparency, since this also allows citizens to hold companies accountable for the impact they have on their communities.*

ILLICIT FINANCIAL FLOWS

Illicit financial flows describe the movement of money that is illegally acquired, transferred or spent across borders. The sources of the funds of these cross-border transfers come in three forms: corruption, such as bribery and theft by government officials; criminal activities, such as drug trading, human trafficking, illegal arms sales and more; and tax evasion and transfer mispricing.

Why it matters*: The volume of illicit financial flows is huge. They have a major impact on the global economy with a devastating impact on poorer countries and have clear links to corruption. Secrecy jurisdictions play a major role in receiving illicit financial flows. Governments should establish mandatory, public registers that disclose the beneficial ownership of trust funds and companies to allow illicit financial flows to be more easily traced and make it harder for people to benefit from the proceeds of corruption and crime.*

KNOW YOUR CUSTOMER

Know Your Customer (KYC) is a term used to describe a set of money laundering measures normally mandated by law which are employed by banks and other financial services to document the true identity of a customer/client and his or her source of wealth to make sure it is legitimate. The KYC information is compiled and retained in a client “profile” that is periodically updated. Actual activity over the account is compared to the KYC profile to identify activity that raises suspicions of money laundering.

Why it matters*: A sound Know Your Customer program is one of the best tools in a good anti-money laundering program for detecting suspicious activity.*

MONEY LAUNDERING

Money laundering is the process of concealing the origin, ownership or destination of illegally or dishonestly obtained money by hiding it within legitimate economic activities to make them appear legal.

Why it matters: *Money laundering thrives when assets can be hidden through shell companies and opaque ownership structures. Governments should establish mandatory, public registers that disclose the beneficial ownership of trust funds and companies to make it more difficult and less attractive for people to benefit from the proceeds of corruption and crime. A sound Know Your Customer program is one of the best tools in a good anti-money laundering program for detecting suspicious activity.*

MUTUAL LEGAL ASSISTANCE

Mutual Legal Assistance is the formal process of cooperation between two or more jurisdictions, for example on cross-border money laundering, asset recovery and tax evasion cases. Through this cooperation, which is usually enacted through a treaty, a State can ask for and receive assistance in gathering information and evidence from private and public sources for use in official investigations and prosecutions.

Why it matters: *Governments should ensure greater domestic and international inter-agency cooperation to enable more effective and faster cross-border sharing of information.*

NOMINEE (NOMINEE DIRECTOR, NOMINEE OWNER, NOMINEE SHAREHOLDER, ETC.)

Nominees act as the legal manager, owner or shareholder of limited companies or assets. They act on behalf of the real manager, owner or shareholder of these entities. These nominees obscure the reality of who is really operating or benefiting from the company and are often used when the beneficial owners do not wish to disclose their identity or role in the company. Professional nominees are paid a fee for their services but otherwise have no interest in the transactions. Nominees could also be family members or friends. Often, nominees pre-sign documentation, such as letters of resignation, which the beneficial owner can choose to affect at any time.

Why it matters: *Governments should establish mandatory, public registers that disclose the beneficial ownership of trust funds and companies. Public registers of beneficial ownership would allow ill-gotten gains to be more easily traced and make it more difficult and less attractive for people to benefit from the proceeds of corruption and crime.*

POLITICALLY EXPOSED PERSONS (PEP)

Politically Exposed Persons are individuals who hold or held a prominent public function, such as the Head of State or government, senior politicians, senior government, judicial or military officials, senior executives of state-owned corporations, or important political party officials. The term often includes their relatives and close associates. Banks and other financial institutions are supposed to treat these clients as high-risk, applying enhanced due diligence at both the start of the relationship and on an on-going basis, including at the end of a relationship to ensure that the money in their bank account is not the proceeds of crime or corruption.

***Why it matters**: Banks must subject Politically Exposed Persons to more robust and effective Enhanced Due Diligence checks to ensure the legitimacy of their source of wealth.*

REVOLVING DOORS/ “COOLING OFF” PERIODS

The term ‘revolving door’ refers to the movement of individuals between positions of public office and jobs in the private or voluntary sector, in either direction. If not properly regulated, it can be open to abuse. A cooling off period is the minimum time required between switching from the public to the private sector intended to discourage the practice and minimise its impact.

***Why it matters**: Reasonable minimum cooling-off periods should be adopted by governments to mitigate the risk of conflicts of interest. They should accompany a comprehensive, transparent and formal assessment procedure which assesses whether post-public office employment is compatible with former duties.*

SECRECY JURISDICTION

Secrecy jurisdictions are territories, including cities, states/provinces and countries that encourage the relocation of otherwise foreign economic and financial transactions through strong privacy protection rules. These jurisdictions ensure that the identity of those relocating their money through them cannot be disclosed. This often undermines legislation and regulation of another jurisdiction. Many secrecy jurisdictions are also tax havens.

***Why it matters**: All jurisdictions should ensure high standards of transparency, accountability and integrity, and take part in multilateral information sharing and mutual legal assistance schemes. All jurisdictions should establish mandatory, public registers that disclose the beneficial ownership of trust funds and companies.*

SHELL COMPANIES

A shell company or corporation is a limited liability entity having no physical presence in their jurisdiction, no employees and no commercial activity. It is usually formed in a tax haven or secrecy jurisdiction and its main or sole purpose is to insulate the real beneficial owner from taxes, disclosure or both. Shell companies are also referred to as international business companies, personal investment companies, front companies, or "mailbox"/"letterbox" companies.

***Why it matters**: Governments should establish mandatory, public registers that disclose the beneficial ownership of trust funds and companies. Public registers of beneficial ownership would allow ill-gotten gains to be more easily traced and make it more difficult and less attractive for people to benefit from the proceeds of corruption and crime.*

TAX EVASION/AVOIDANCE

Tax evasion is the illegal non-payment or under-payment of taxes, usually by deliberately making a false declaration or no declaration to tax authorities - such as by declaring less income, profits or gains than the amounts actually earned, or by overstating deductions. It entails criminal or civil legal penalties. Tax avoidance is the legal practice of seeking to minimize a tax bill by taking advantage of a loophole or exception to the rules, or adopting an unintended interpretation of the tax code. It usually refers to the practice of seeking to avoid paying tax by adhering to the letter of the law but opposed to the spirit of the law. Proving intention is difficult; therefore the dividing line between avoidance and evasion is often unclear.

Why it matters: Tax evasion is facilitated by complex and opaque corporate structures and hidden company ownership. Governments should establish mandatory, public registers that disclose the beneficial ownership of trust funds and companies to allow ill-gotten gains to be more easily traced. Enhanced corporate transparency provides information that can monitor behaviour.

TAX HAVEN

Tax havens are jurisdictions, including cities, states or countries that grant favourable tax treatment which can benefit non-residents. They attract relocation of economic transactions to their territory by applying no or minimal tax rates. They typically host a range of financial service providers. Many tax havens are also secrecy jurisdictions.

***Why it matters**: All jurisdictions including tax havens should ensure high standards of transparency, accountability and integrity, and take part in multilateral information sharing and mutual legal assistance schemes.*

TRANSFER (MIS)PRICING

Transfer pricing is the process through which parent companies and/or subsidiaries of the same parent, in different countries, establish a price for goods or services between themselves. Transfer mispricing is the abusive manipulation of this process for the purpose of avoiding or reducing taxes across all entities. This takes place when related firms agree to manipulate the price of their internal transactions in order to declare less profit in higher-tax jurisdictions and therefore reduce their total tax payments. It deliberately generates profit and hides or accumulates money in the jurisdiction where the tax bill is low.

Why it matters*: Companies should ensure high levels of corporate transparency, since this allows citizens to hold companies accountable for the impact they have on their communities. Multinationals operate through networks of related entities incorporated under diverse legislation that are inter-related through myriad legal and business connections. Without transparency, many transactions are almost impossible to trace.*

ADDITIONAL INFORMATION

For additional information see the following sources:

Basel Institute of Governance: Glossary http://www.assetrecovery.org/kc/node/786c5ae2-5c7c-11dd-8c6a-7bd68e2d933e.html

Financial Action Task Force: Glossary http://www.fatf-gafi.org/pages/glossary/

Financial Transparency Coalition: Glossary http://www.financialtransparency.org/resources-2/glossary/

OECD: Clean Gov Biz Toolkit http://www.oecd.org/cleangovbiz/toolkit/

Tax Justice Network – Financial Secrecy Index: http://www.financialsecrecyindex.com/introduction/nextsteps

Transparency International: Anti-Corruption Plain Language guide: http://archive.transparency.org/publications/publications/other/plain_language_guide

UNODC: Documents, publications and tool – Prevention and fight against corruption. http://www.unodc.org/unodc/en/corruption/publications.html

U4 Anti-Corruption Research Centre: Glossary http://www.u4.no/glossary/

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